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IN THE

Supreme Court of the United States

OCTOBER TERM, 1972

No. 72-486

FEDERAL POWER COMMISSION, *Petitioner*

v.

MEMPHIS LIGHT, GAS AND WATER DIVISION, ET AL.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF OF MEMPHIS LIGHT, GAS AND WATER DIVISION IN OPPOSITION

OPINIONS BELOW

The initial opinion of the Court of Appeals (App. A, Pet. for Cert., pp. 17-39) and its opinion on rehearing (App. B, Pet., pp. 41-53) are not yet reported. The initial opinion (No. 578) of the Federal Power Commission (App. D, Pet., pp. 57-66) and its opinion on rehearing (No. 578-A; App. E., Pet., pp. 67-71) are reported at 43 FPC 824 and 44 FPC 140.

JURISDICTION

The judgment of the Court of Appeals was entered on February 18, 1972 (App. C, Pet., pp. 55-56), and the Commission's petition for rehearing was denied on May 11, 1972 (App. B, Pet., pp. 41-53). On August 4, 1972, the Chief Justice extended the time for filing a petition for a writ of certiorari to September 23, 1972. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b).

STATUTE INVOLVED

Section 441 of the Tax Reform Act of 1969, 83 Stat. 625, 26 U.S.C. 167(1), is set forth in App. F, *infra*, pp. 73-78.

QUESTION PRESENTED

Whether the Court below correctly construed Section 441(a) of the Tax Reform Act of 1969 as having retained the existing tax depreciation practices of natural gas pipeline companies with respect to properties held prior to January 1, 1970, and replacements of such properties.

STATEMENT

The issue in this case relates to the proper construction of Section 441(a) of the Tax Reform Act of 1969, and its effect upon the regulatory practices and policies of the Federal Power Commission.

The United States Court of Appeals for the District of Columbia held that the effect of the statute was to permit certain regulated utilities to change their depreciation practices with respect to new property acquired after December 31, 1969 which increased the produc-

tive or operational capacity of the company and did not represent replacement of existing capacity. The Court held that the new Act did not permit such change in depreciation practices for any other properties of the regulated utilities.

The effect of this ruling was (1) to avoid wide-spread and substantial utility rate increases at the present time, (2) to permit utilities gradually to change over from accelerated depreciation with flow-through to accelerated depreciation with normalization,[1] as new expansion properties were added to their systems after 1969.

The Opinion below reversed Opinion No. 578 and 578A of the Federal Power Commission, which construed Section 441(a) of the Tax Reform Act of 1969 as having placed the Commission in a position where practical consideration made it encumbent upon the Commission to permit regulated utilities to use accelerated depreciation with respect to all of their properties, both new and old, and to normalize their tax payments for the purpose of computing cost of service to their customers (Pet., App. D, pp. 64-65).

The practical effect of the Commission's interpretation of the new Act, as conceded in the Petition (p. 15), is to necessitate present rate increases by practically all of the interstate natural gas pipelines, as well as many other regulated utilities in the country.

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[1] As explained in the Commission's Petition For Certiorari (pp. 4-5), when the tax benefits of accelerated depreciation are "flowed through", the customers of the regulated utilities receive the benefits in the form of lower cost of service; when those benefits are "normalized", the regulated utility computes its taxes with the use of liberalized depreciation, but computes its cost of service as if it had paid taxes on the basis of straightline depreciation.

ARGUMENT

The result reached by the Court of Appeals accords precisely with the stated purposes of Congress in the legislative history of Section 441(a) of the Tax Reform Act of 1969, and produces precisely the result which Congress intended and expected from that Act. The contrary interpretation proposed by the Federal Power Commission would create the very situation which Congress sought to avoid and thought it had avoided.

The overall purpose of Section 441(a) was to stop the current trend which indicated that regulated utilities were being required by their regulatory Commission to change from accelerated depreciation with normalization to accelerated depreciation with flow-through. The reason for stopping the trend was that there was a greater revenue loss to the Treasury from the use of flow-through than from the use of normalization.[2]

This reason was succinctly stated in the Senate Finance Committee Report accompanying HR 13270:

> General reasons for change.—The trends of recent years are shifts from straight line to accelerated depreciation and shifts from normalization to flow-through, often against the will of the taxpayer utilities. In general, flow through to customers doubles the tax revenue loss involved in shifting from straight line to accelerated depreciation. It is understood that continuation of these trends would shortly lead to revenue losses of approximately $1.5 billion. Such a revenue loss from this

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[2] This is because the normalization method permits the utility to pocket the tax savings resulting from use of liberalized depreciation, and the increased revenues constitute taxable income.

> item is unacceptable at this time. On the othe hand, a rule requiring all such utilities to shift t straight line depreciation would place regulate utilities at an unfair competitive disadvantage both in terms of the sale of their products or serv ices and their attractiveness to equity investors U.S. Code Cong. & Ad. News, Vol. 2, 1969, p. 2204

A similar statement was made by the House Committee On Ways and Means (U.S. Code Cong. & Ad News, Vol. 2, 1969, pp. 1782-3).

While the legislation was under consideration in Committee, the Federal Power Commission suggested the problem be solved by simply requiring all regulated utilities to switch to straight-line depreciation. This suggestion was expressly rejected by the House Committee which stated in its Report:

> Consideration has been given to suggestions by the Federal Power Commission and others that regulated utilities no longer be permitted to use a method of depreciation other than straight line. However, your committee concluded that, in too many cases, this would place regulated utilities at an unfair competitive disadvantage, both in terms of the sale of their products or services and their attractiveness to equity investors. Also, this would result in prompt, substantial, and widespread utility rate increases. (U.S. Code Cong. & Ad. News, Vol. 2, 1969, p. 1783)

Time and again the Committees of both Houses reiterated their desire to avoid, as a consequence of Section 441(a), any substantial present rate increases. The Congress did not desire to institute a substantial change in depreciation practices, but rather to "freeze" the situation as it was at the time the legisla-

tion was passed. Thus, the House Ways and Means Committee stated at Page 132 of its Report accompanying HR 13270:

> Accordingly, *your committee has determined in general to 'freeze' the current situation regarding methods of depreciation* in the case of those companies in what are, by and large, the more healthy utility industries. (House Report of Committee on Ways and Means [to Accompany HR 13270], 91st Cong. 1st Sess., p. 132; U.S. Code Cong. and Adm. News, 1969, Vol. 2, p. 1783). (Italics added)

The Senate Report concurred, saying (U.S. Code Cong. and Adm. News, 1969, Vol. 2, pp. 2204-5, 91st Cong., 1st Sess.):

> Accordingly, the committee agrees with the House that *it is appropriate to in general 'freeze' the current situation* regarding methods of depreciation in the case of those companies in what are, by and large, the more flourishing utility industries. (Italics added)

In the course of the tax bill through the two Houses of Congress, an attempt was made in the Senate to permit the regulated utilities to elect, within 180 days from the enactment of the Act, to shift from the flow-through to the straight line method, with respect to all of their properties, both new and existing (U.S. Code Cong. & Ad. News, 1969, p. 2206). This, however, would have defeated the purposes above set forth, in that it would have permitted the regulated utilities to normalize with respect to all of their properties, which would have almost the identical effect on rates as if the utilities had used straight line depreciation.[3] Accordingly, the House refused to concur, and the ultimate result was to

[3] The effect of normalization is not quite the same as that of straight-line depreciation, because the rate payer is not required to pay a return on his contribution of fictional taxes to the utility.

permit an election only with respect to new property which increased the capacity of the taxpayer and did not represent replacement of existing property (Section 441(a)(4)(A), Pet. App. F, p. 77). The restriction of the election to post-1969 expansion property, of course, meant that it would have no immediate rate impact. Each year thereafter, as utilities added expansion properties, and retired pre-1970 properties, the change-over to normalization would gradually take effect.

When the bill was molded into its final form, the Congress was still of the firm impression that it had avoided any wide-spread substantial utility rate increases. The report of the Staff of the Joint Committee states that the bill had been drawn:

> . . . in a way that (with very few exceptions) will require no increase in utility rates, because of the tax laws, since by and large, it merely takes the various regulatory situations as it finds them and freezes those situations. (Summary HR 13270 Tax Reform Act of 1969 by Staff of Joint Committee on Internal Revenue Tax, p. 73).

The Opinion of the Court of Appeals, after specifically citing the above statement, held:

> There is nothing in the Tax Reform Act of 1969, then, which modifies the Commission's duty under the Natural Gas Act to require regulated utility companies such as Texas Gas, which had been using liberalized depreciation with flow-through with respect to their pre-1970 and post-1969 non-expansion property, to set rates which reflect actual expenditures alone with respect to such property. According to Congress, the only appropriate tax allowance for ratemaking purposes for a company such as Texas Gas, which has been using liberalized depreciation with flow-through with respect to its

pre-1970 and post-1969 non-expansion property, is the income taxes actually paid (Pet., App. A, p. 36).

The complaint by the Commission against the judgment of the Court of Appeals is that it fails to construe the new tax Act in such a way as to require the immediate, substantial, wide-spread rate increases which would inevitably result from the use of fictitious straight-line tax depreciation in computing cost of service.

It is submitted that the result of the Court of Appeals accords precisely with the intent of Congress, and the result desired by the Federal Power Commission accomplishes the very rate increases Congress desired to prevent and treats the customer as if the utilities were on a straight-line depreciation basis, a proposal expressly rejected by Congress.

CONCLUSION

Since the opinion of the Court of Appeals accords with the clearly expressed intent of Congress, and the position taken by the Commission is totally inconsistent therewith, the Petition for Writ of Certiorari should be denied.

Respectfully submitted,

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